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No. 88-93

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Supreme Court of the United States

OCTOBER TERM, 1988

**UNION PACIFIC RAILROAD COMPANY,
MISSOURI PACIFIC RAILROAD COMPANY,
THE WESTERN PACIFIC RAILROAD COMPANY, AND
SPOKANE INTERNATIONAL RAILROAD COMPANY,**

Petitioners,

VS.

**TERRY F. MORITZ, TRUSTEE OF
IOWA RAILROAD COMPANY,**

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

RESPONDENT'S BRIEF IN OPPOSITION

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RESPONDENT'S BRIEF IN OPPOSITION

STATEMENT OF THE CASE

This case arose as an adversary proceeding in the bankruptcy of the Iowa Railroad Company ("Iowa Railroad"). Approximately six months after the commencement of the Iowa Railroad's bankruptcy proceedings, the Union Pacific Railroad Company, Missouri Pacific Railroad Company, The Western Pacific Railroad Company and Spokane Inter-

national Railroad Company (collectively hereinafter referred to as "Union Pacific") instituted litigation seeking to impress a trust on the assets of the Iowa Railroad in order to satisfy Union Pacific's claims against the Iowa Railroad for interline freight balances. Interline freight balances are net debtor-creditor accounts between railroads that result when a shipper pays to a single railroad the total freight charge owing for the movement of goods over the lines of two or more railroads.

Iowa Railroad was a small, regional railroad that existed for only three years. It was incorporated in August, 1981, and commenced rail operations in November, 1981. As Union Pacific notes in its Petition, Iowa Railroad operated over 511 miles of rented track, largely with leased equipment. Petition, p. 5, n.5. Iowa Railroad ceased rail operations on or about October 31, 1984. Trustee's Memorandum Respecting Cross-Motions for Summary Judgment, Ex. A, Gene R. Schwab Aff., ¶¶ 6-7 (hereinafter cited as "Trustee Ex. ____"). Union Pacific's claims for unpaid interline freight are for the period July, 1983 to November, 1984. Complaint, Ex. A. During that period, Iowa Railroad did not pay interline freight balances promptly. At times, payments to some carriers (including Union Pacific) were not made until 60-90 days after a bill was received. At no time did Union Pacific complain about late payments or demand immediate payment of past due balances. Trustee Ex. F, Stauffacher Aff., ¶¶ 6-8.

In its Petition, Union Pacific describes the interline settlement procedures used by the members of a private trade association, the Association of American Railroads (the "AAR"). Petition, pp. 4-5, n.4. As the Seventh Circuit noted in its opinion, the voting membership of the AAR consists of approximately 28 Class I railroads (i.e., railroads with annual operating revenues of $50,000,000 or more) and their subsidiaries and affiliates. The interline

settlement procedures described by Union Pacific are regulated by the AAR. 840 F.2d 535, 543. The Iowa Railroad was never a member of the AAR. Trustee's Ex. E, Susan Schwab Aff., ¶ 27.

AAR member roads have developed a sight draft system which uses microencoded plastic cards (the "MICR System"). Under the MICR System, a railroad that is owed interline freight balances at the end of a month does not have to issue a bill and wait for the debtor railroad to prepare and mail a check. Instead, the creditor railroad uses the microencoded plastic card and a printing machine to prepare a sight draft against the debtor road's bank account. Under this system, a creditor road places the MICR sight draft into the federal banking system and obtains payment immediately after the net freight balance is calculated. 840 F.2d 535, 543.

For a six month period in 1982, Iowa Railroad voluntarily elected to follow the MICR System. Trustee's Ex. E, Susan Schwab Aff., ¶ 24. However, in July 1982, Iowa Railroad withdrew from this system and instituted a bill and voucher system. During the period from August, 1983 to November 2, 1984, Iowa Railroad did not pay interline freight balances unless it received two separate documents: the summary of the abstracts of waybills for a particular month, which showed the net balance owed by Iowa Railroad, and a bill requesting payment of the amount shown on the summary. *Id.* at ¶ 25. Iowa Railroad implemented this change in order to exercise strict control over the timing of payments of interline freight accounts and to better manage its cash flow. *Id.* Union Pacific's claims arose after Iowa Railroad changed to a bill and voucher system.

In the decision below, the Seventh Circuit determined that Union Pacific was not entitled to impress a trust on the assets of Iowa Railroad and that a debtor-creditor rela-

tionship existed between Iowa Railroad and Union Pacific. 840 F.2d 535, 545 (7th Cir. 1988). This determination is fully supported by the record below which established that (1) all interline freight payments collected by Iowa Railroad were deposited in its general corporate accounts, and commingled with revenues from other sources (Trustee's Ex. E, Susan Schwab Aff., ¶ 10); (2) Iowa Railroad's business expenses were paid out of these commingled funds, *id.*; and (3) amounts paid or owed by shippers for interline freight movements were always treated on Iowa Railroad's balance sheets as assets of Iowa Railroad, either as cash or accounts receivable, and revenues attributable to movements on the lines of other railroads (whether or not collected) were treated as accounts payable. *Id.* at ¶ 7.

REASONS TO DENY THE WRIT

Summary Of Argument

In the decision below, the Seventh Circuit correctly applied this Court's 1979 decision, *Butner v. United States*, 440 U.S. 48 (1979), which requires that the rights of a claimant in bankruptcy be established by looking to local law. The court below applied Illinois law to the record before it and determined that Union Pacific is not a trust claimant but a creditor of the Iowa Railroad. 840 F.2d 535, 545. Petitioner now seeks to obtain further review in this Court by asserting that this holding conflicts with *In re Penn Central Transp. Co.*, 486 F.2d 519 (3d Cir. 1973) (en banc), *cert. denied*, 415 U.S. 990. The petitioner is wrong. In *In re Penn Central Transp. Co.*, the Third Circuit applied state-law principles and found that the Penn Central Transportation Company ("Penn Central")

had agreed to become a fiduciary of other interline railroads when it collected interline freight balances. Both the Third and Seventh Circuits declined to create a unique federal rule of decision for the railroad industry. 840 F.2d 535, 542; 486 F.2d 519, 527.

The different results reached by these circuits in applying state law to similar but by no means identical facts do not constitute a split in the circuits. Rather, these differences reflect only the permissible variations that arise when federal courts look to state-law rules of decision and apply those rules to different fact patterns. These differences in result are necessarily commonplace in our federal system and have never been an adequate reason for granting a writ of certiorari.

1. THERE IS NO SPLIT IN THE CIRCUITS

In the decision below, the Seventh Circuit correctly followed this Court's 1979 decision, *Butner v. United States*, 440 U.S. 48 (1979). The Seventh Circuit held that "state law is the usual source of creditors' rights in bankruptcy cases" and refused to create a federal common law rule granting the railroad industry a unique status denied to all other industries. 840 F.2d 535, 539 and 541. In so ruling, the Seventh Circuit examined and rejected all the arguments that Union Pacific raises again in its Petition. The court below determined that there is no compelling federal interest at stake in the controversy between Iowa Railroad and Union Pacific that requires the creation of a federal rule of decision. 840 F.2d 535, 540.

Union Pacific vigorously argues that the notion of a national transportation policy requires a departure from the principle of *Butner* and the creation of a federal common law to establish the rights of railroads that have interline freight claims in bankruptcy. However, as the court below

noted, national transportation policy is codified in the Staggers Rail Act of 1980, 49 U.S.C. § 10101a. In the Staggers Rail Act, Congress has expressly proclaimed that maximizing competition and minimizing federal regulation of the railroad industry is the current national transportation policy. 49 U.S.C. § 10101(a)(1) and § 10101(a)(2). The Staggers Rail Act "does not mention promoting a unified rail system." 840 F.2d 535, 540.[1] The Seventh Circuit also found that "[t]he Interstate Commerce Act does not mention interline balances" and the Interstate Commerce Commission "has not exercised regulatory power . . . with respect to freight or passenger interline balances." *Id.*

Furthermore, the Seventh Circuit found no basis for the creation of a uniform federal common law rule to govern the property interests of Union Pacific. The court noted that Union Pacific and Iowa Railroad are merely private litigants. 840 F.2d 535, 540. Moreover, the court could identify no "substantial conflict between state law and the achievement of an objective defined by federal law." *Id.* Additionally, the court stated that no other industry that involves interline balances or similar collection procedures has been granted the uniform federal rule of decision that Union Pacific seeks for the railroad industry. 840 F.2d 535, 541. Instead, the court below applied Illinois law to the facts before it and concluded that Iowa Railroad had no intent to become a fiduciary of Union Pacific.

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[1] In his concurrence to the *Penn Central* decision, Judge Adams found the statutory support for a national transportation policy that promoted a unified rail system in the preamble to the Interstate Commerce Act as it existed before the enactment of the Staggers Rail Act in 1980. 486 F.2d 519, 531. As the Seventh Circuit notes, that statutory framework no longer exists. 840 F.2d 535, 540.

Union Pacific predicates its perceived split in the circuits on a concurrence in the *Penn Central* case. In that concurrence, Judge Adams raises the unfounded spectre of the demise of the railroad industry if railroads are treated like all other transportation industries that interchange freight and passengers. The majority opinion in the *Penn Central* decision flatly rejected Judge Adams' call for a special federal common law rule for railroads:

> The concurring opinion expresses concern because of our reliance upon established principles of trust law which may in some future case, when possibly "the traditional indicators of a trust relationship" are absent, require a contrary holding and thus might disrupt interline railroad transportation. . . . We perceive no need to announce an entirely new and necessarily result-oriented rule of law which is not pertinent to our present decision, merely because of the fear that the traditional approach may be restrictive in some future unstated hypothetical situation.

486 F.2d 519, 527.[2]

The Seventh and Third Circuits each applied state-law principles to the particular cases before them and reached different decisions about whether a trust relationship existed among the parties before each court. Differing decisions made on the basis of state law do not constitute a real and embarrassing conflict of opinion between circuit courts of appeal; rather such differences are merely the permissible outcome of a healthy federal system. Conflict among circuits on issues governed by state law "is

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[2] Union Pacific also cites the Sixth Circuit's decision, *Chase v. Committee of Interline R.Rs. (In re Ann Arbor R.R. Co.)*, 623 F.2d 480 (6th Cir. 1980). As Union Pacific notes in its Petition (Petition, p. 14), the Sixth Circuit essentially adopted the reasoning of the Third Circuit in the *Penn Central* case. 623 F.2d 480, 482.

not of itself a reason for granting a writ of certiorari." *Ruhlin v. New York Life Ins. Co.*, 304 U.S. 202, 206 (1938).

Moreover, this Court has recognized that review of a circuit court's determination of state-law issues is inappropriate because "[t]he federal judges who deal regularly with questions of state law in their respective districts and circuits are in a better position to determine how local courts would dispose of comparable issues." *Butner*, 440 U.S. 48, 58. The Seventh and Third Circuits have each applied state law to an issue that is and should be governed by state law. Moreover, the decision below is in full accord with the principle of *Butner*; therefore, the writ should be denied.

2. UNION PACIFIC'S OTHER CASES ARE INAPPOSITE

Union Pacific's reliance on cases other than *Penn Central* to create a federal common law of property interests is unfounded. As it has throughout this litigation, Union Pacific confuses the issue of the nature of an interline creditor's property interest in funds collected by another railroad with the quite different issue of what priority of payment an interline creditor is entitled to receive from the estate of an insolvent debtor. Union Pacific cites three cases that deal solely with the issue of priority of payment to manufacture a split in the circuits.

For example, to support its erroneous assertion that the *Penn Central* case was not decided on state-law rules of decision, Union Pacific looks not to the language of the *Penn Central* decision itself but rather to another Third Circuit decision entered eight years later, *In re Lehigh and New England Ry. Co. (Appeal of Central New Jersey Indus., Inc.)*, 657 F.2d 570 (3d Cir. 1981). The *Lehigh* de-

cision did not adjudicate the issue of the nature of the interline creditors' property interests nor did it adjudicate what rule of decision would apply to that issue.[3] In fact, the Third Circuit expressly stated that the *sole* issue before it on appeal was the relative priority that various claimants, including the interline railroads, were to be accorded in the distribution of the proceeds of the sale of the Lehigh and New England Railway Company's rail assets to Conrail. 657 F.2d 570, 573.

Union Pacific's reliance on two 1962 cases involving Southern Railway Company ("Southern") is equally irrelevant. These two cases were also concerned solely with the issue of priority of payment. Before the Fifth Circuit, Southern sued the United States of America to determine whether Southern's status as a creditor of the Tallulah Falls Railway Company ("Tallulah Falls") entitled it to priority of payment ahead of allowed tax claims. *Southern Ry. Co. v. United States,* 306 F.2d 119 (5th Cir. 1962). The receiver of the Tallulah Falls had violated an express court order requiring him to segregate interline balances owed to Southern and had used those funds to pay Southern's operating expenses. 306 F.2d 119, 123. Despite the receiver's violation of the prior court order to segregate and turn over funds to Southern, the court determined that Southern's interline claims should receive only the same priority of payment as other operating expenses. 306 F.2d

[3] The *Lehigh* proceeding was an equity receivership that was before the federal court based on diversity jurisdiction. The Lehigh sought to liquidate, but Section 77 of the Bankruptcy Act in effect at the time the *Lehigh* proceeding was filed did not permit liquidation of a railroad. 657 F.2d 570, 572, n.4. While the Third Circuit does discuss the issue of whether federal or state law applies to the question before it in the *Lehigh* case, that discussion is merely *dicta.*

119, 125. The Fourth Circuit's *Southern* decision also adjudicates only the issue of relative priority of payment among creditors. The source of the interline creditors' property rights was not at issue. In fact, the Fourth Circuit began its discussion by labelling Southern and the other interline railroads as general creditors of the debtor railroad. *Southern Ry. Co. v. Flournoy*, 301 F.2d 847, 850 (4th Cir. 1962).

These decisions do not support Union Pacific's contention that there is a split in the Circuits. Each of these cases adjudicates the issue of priority of payment in a railroad insolvency. None of them deals with the issue that was before the Seventh Circuit—whether property rights of private litigants are determined by reference to state-law rules of decision. There is no split in the circuits on this issue; therefore, the writ should be denied.

3. THE IOWA RAILROAD PRESENTS A UNIQUE FACT SITUATION

In examining the record before it, the Seventh Circuit found that Iowa Railroad had no intent to enter into a trust relationship with Union Pacific. 840 F.2d 535, 545. To reach this conclusion, the court reviewed the significant factual differences that distinguish the relationship that once existed between Union Pacific and the Iowa Railroad from the relationship that existed between Penn Central and the interline creditors in the Penn Central bankruptcy. 840 F.2d 535, 543-44. These factual distinctions led the Seventh Circuit to correctly characterize Union Pacific as a creditor of the Iowa Railroad.

Unlike the Penn Central and its interline creditors, Iowa Railroad was never a member of the AAR and did not agree to abide by the revenue settlement procedures pre-

scribed by the AAR. 840 F.2d 535, 544. During the period in question, Iowa Railroad treated interline balances it collected as accounts receivable and interline balances it owed as accounts payable. 840 F.2d 535, 539. Iowa Railroad did not permit other railroads to issue sight drafts on its accounts in payment of interline balances. 840 F.2d 535, 544. In short, Iowa Railroad never manifested any intent, express or implied, to hold interline balances in trust for Union Pacific or any other railroad.

The Seventh Circuit did not adjudicate the status of interline balances collected by one member of the AAR for freight movements carried over the line of another member of the AAR as the Third Circuit did in the *Penn Central* bankruptcy. In fact, Judge Easterbrook noted

> We are sympathetic to the contention that the AAR's accounting rules, coupled with the system of sight drafts that give creditor lines effective dominion over the funds, is the practical equivalent of a trust.

840 F.2d 535, 544. However, those facts do not exist in this case as they did in *Penn Central*; therefore, review is not appropriate.

CONCLUSION

The issue before this Court on Union Pacific's petition for a writ of certiorari is whether private parties must accept the fact that their property interests are defined by reference to state law and that decisions based on state law may vary from jurisdiction to jurisdiction. That issue has already been decided by this Court in *Butner v. United States*, 440 U.S. 48 (1979), and the Seventh Circuit cor-

rectly followed this Court's *Butner* decision in the opinion below.

Wherefore, respondent respectfully requests that this Court deny the petition for a writ of certiorari to the United States Court of Appeals for the Seventh Circuit.

Respectfully submitted,

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